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January 25, 2004

Mary Cottrell, Secretary
Department of Telecommunications and Energy
One South Station, Second floor
Boston, MASS. 02110

RE: Default Service Procurement for Small Customers, D.T.E. 04-115

Dear Secretary Cottrell:

Enclosed for filing are an original and ten copies of the Comments of Massachusetts Community Action Program Directors' Association, Inc. (MASSCAP) in this docket.

Please contact me with any questions.

Sincerely,

Massachusetts Community Action Program Directors' Association, Inc.

By its attorney,

COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND UTILITIES

Procurement of Default Service Power Supply for Residential and Small Commercial and Industrial Customers	))))	D.T.E. 04-115

COMMENTS OF MASSACHUSETTS COMMUNITY ACTION PROGRAM DIRECTORS' ASSOCIATION, INC. (MASSCAP)

This is the Initial Comment of the Massachusetts Community Action Program Directors' Association, Inc. (MASSCAP), which represents most of the agencies that make up the weatherization and fuel assistance program network designated in G.L. c.25, sec. 19. MASSCAP agencies deliver federal and utility weatherization and energy efficiency services to low-income families across the Commonwealth. MASSCAP agencies also deliver federal fuel assistance benefits to their low-income clients. (The Federal weatherization and fuel assistance programs are administered in Massachusetts by the Department of Housing and Community Development. Utility weatherization and efficiency services are overseen by this Department and the Division of Energy Resources.) MASSCAP agencies also deliver many other services to their low-income clients, including counseling with respect to electricity bills. This counseling includes budget counseling and assistance arranging payment plans and signing up for low-income rates.

MASSCAP agencies are thus in a unique position to report on the experience of low-income consumers under the 1997 Electric Restructuring Act and to make recommendations to the Department on how default service procurement policies could be modified to ensure benefits of the competitive wholesale market accrue to all low-income ratepayers in the Commonwealth.[1]

MASSCAP is grateful for this opportunity to present its views to the Department on some of the most important issues now before it. At the outset, we set out six principles adopted last year by a broad spectrum of interests,[2] including labor, utilities, traders, and low-income and residential consumer organizations:[3]

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[1] *See* Request for Comments in this docket at 2-3 (Dec. 6, 2004).
[2] Massachusetts Community Action Program Directors' Association, Inc. (MASSCAP), Massachusetts Energy Directors Association, Action Energy, Massachusetts Union of Public Housing Tenants, MASSPIRG, Utility Workers Union of America, TransCanada Power Marketing, Sempra Energy Trading, NSTAR, and Western Massachusetts Electric Co.
[3] Letter to Hon. Michael W. Morriseey, Senate Chairman, and Hon. Daniel E. Bosley, House Chairman, Joint Committee on Government Regulations (June 9, 2004).

- The overall objective of restructuring was and remains to produce real benefits for all customers.

- Default Service provided by local utilities may be the only viable energy option for small, residential and low-income customers for the foreseeable future; such service provides a valuable means of delivering the benefits of the wholesale competitive market to those customers, and should continue to be offered to them

- Customers should not be forced to pay rates for Default Service that exceed the market-based, competitively established costs to serve them.

- Retail ***choice*** should be maintained and therefore customers should not be involuntarily assigned to retail suppliers (i.e., slammed).

- Default Service for small customers should be procured and priced over a longer term, in order to assure greater price stability for those customers.

- Any mandated procurement process for Default Service should be flexible enough to allow utilities to make purchases that are in the customers' best interests and result in the lowest reasonable price for customers.

Executive Summary

Although Restructuring promised small consumers new choices and lower prices, the reality is that fewer than three percent of residential customers are served by an alternative electricity supplier (the Cape Light Compact aggregation in nearly all cases) and electricity prices are as much as 34 percent higher than when restructuring took effect. Restructuring's new price volatility – a price variance of as much as 79 percent over four years—is often as difficult to manage as price increases.

Fewer than one percent of low-income customers are served by an alternative supplier. Furthermore, the low-income discount – which reaches only 22 percent of eligible customers -- has been eroded by skyrocketing energy prices. As a result, low-income electricity prices rose 41 percent more than residential rates – jumping by as much as 47 percent.

On March 1, compared to December, electricity rates will surge by as much as another 28 percent.

Too often, for low-income customers, beset with falling benefits and rising rents, the choice is between heating or eating. Low-income families pay about three times the fraction of their incomes on home energy as do median income families. So they actually reduce their caloric intake in the winter and skip medical care. Others reduce heating or cooling, to the detriment of their health. Last winter, a Marshfield woman froze to death in her own home,

Restructuring has been no kinder to the generation industry it was supposed to liberate. At least a third of New England generation has experienced serious financial trouble, including bankruptcy and distress sale.

If no changes are made, the current policy path leads to:

1. Brownouts and blackouts as continued financial instability prevents the financing and construction of new generation when needed.
2. Natural gas shortages, and consequent price spikes -- especially in very cold winters -- as electricity generation becomes more dependent on a natural gas supply that is inadequate and, in many cases, is not even under firm contract.
3. Price increases of 25 percent to support additional experiments in achieving reliability through "market forces" instead of regulation.
4. Continued upward price pressure on all fuels.

Massachusetts energy policy since 1997 contains these features:

1. Initiatives to enhance customer choice, none of which has worked.
2. Permanent and expanded low-income protections in the form of energy efficiency programs – which have been very successful – and rate discounts, which have shrunk in value by as much as 25 percent and (despite important Department and utility efforts) which covers six percent fewer households. NSTAR Electric,

KeySpan, and Western Massachusetts Electric Co., with Department encouragement, have also adopted plans to help low-income customers manage their past due bills.

3. The Department lengthened power procurement contract durations to one year, and laddered purchases, to dampen price volatility.
4. The Commonwealth came very close to running out of gas to generate electricity last winter. Electricity generating capacity shortages in the summer are looming. No state solution to either problem has been developed. The federal government solution to potential electricity shortages is to raise prices by 25 percent.
5. The Commonwealth currently depends almost entirely on the marketplace to set energy prices, with the catastrophic results shown above. The theory in 1997 was that competition and choice would bring "long-term rate reductions," but electric energy rates are two-and-a-half times higher now than they were at the dawn of competition in March 1998.

MASSCAP proposes these policy reforms to help bring price levels and price volatility under control and assure a reliable supply of gas and electricity:

1. Customers are not interested in choosing their energy suppliers. Policymakers should focus on price and reliability.
2. The full value of the low-income discount should be restored. Arrearage management programs should be expanded to other utilities.
3. Default Service purchase terms should be lengthened further, to at least three years, with a mix of contract durations laddered in order to smooth price volatility. The Department should offer to operate procurement programs to serve the territories of utilities that would prefer such an arrangement.
4. The Department should appoint a Builder of Last Resort to build generation on a cost-of-service basis if the market fails to provide the requisite reliability. This will also exert some control on prices, particularly at peak.

Prices and choice: Low-income price increases higher than for other residential customers

The original promise of Restructuring was lower prices and choice.[4] After seven years, the reality for residential customers is much higher prices – especially for low-income customers – and virtually no choice. The lack of choice is illustrated by these data from the Division of Energy Resources, which show that only the large industrial customer class has found meaningful choices in the marketplace.[5] Almost two-thirds of large industrial customers have found competitive offerings that they prefer to utility service. The same is true for *two-thirds of one percent* of low-income residential customers. After seven years, there is no factual evidence to suggest that this lack of retail competition will change.

Percentage of Massachusetts utility electricity customers taking competitive generation	
Low-income residential	0.67%
Non-low-income residential	2.85%
Non-large C&I, including farms	7.42%
Large industrial	62.22%
Source: DOER (as of Nov, 2004)	

The initial 15 percent bill reduction promised by the Restructuring Act[6] has turned into an increase of 33 percent at Massachusetts Electric and 22-34 percent in the NStar territories for non-low-income residential customers.[7] But for low-income customers, price increases are as much as 41 percent greater, ranging from 32 to 47 percent at the same utilities.[8] This is because the low-income discount is applied only to distribution rates and not to the energy rates that have skyrocketed since 1997.

At the same time, the availability of the shrinking discount has itself shrunk. Across the Commonwealth, six percent fewer customers received the low-income electric rate

[4] [C]onsumers [of electricity] will begin to see more competition in the next two years. Suppliers will compete based on price … the potential for savings … [is] significant." Steven M. Rothstein (New England managing director, AES New Energy), "Don't give up on energy law," *Boston Globe* at C4 (Dec. 12, 2000); "Cheaper, cleaner power is on the way." Steve Bailey, "Stay the course," *Boston Globe* at C1 (Feb. 2, 2001) "To be blunt, we were lied to." "Utilities take another swipe at consumers" (editorial), *The Enterprise* (Brockton) at A11 (Dec. 21, 1999).

[5] http://www.mass.gov/doer/pub_info/migrate.htm#nov04, *See* Request for Comments in this docket at 2.

[6] *See* Request for Comments in this docket at n.1.

[7] Based on MASSCAP survey and calculation of bills of 500 kWh (1000 kWh for heating rates) by Theo MacGregor using data from the web sites of the Department and the respective utilities. Changes are from 1999 to 2004. Natural gas price increases are considerably higher.

[8] *Ibid.* Prices increases are much smaller at Western Massachusetts Electric Co. (6% residential), but low-income increases are about double (11% heating, 14% non-heating).

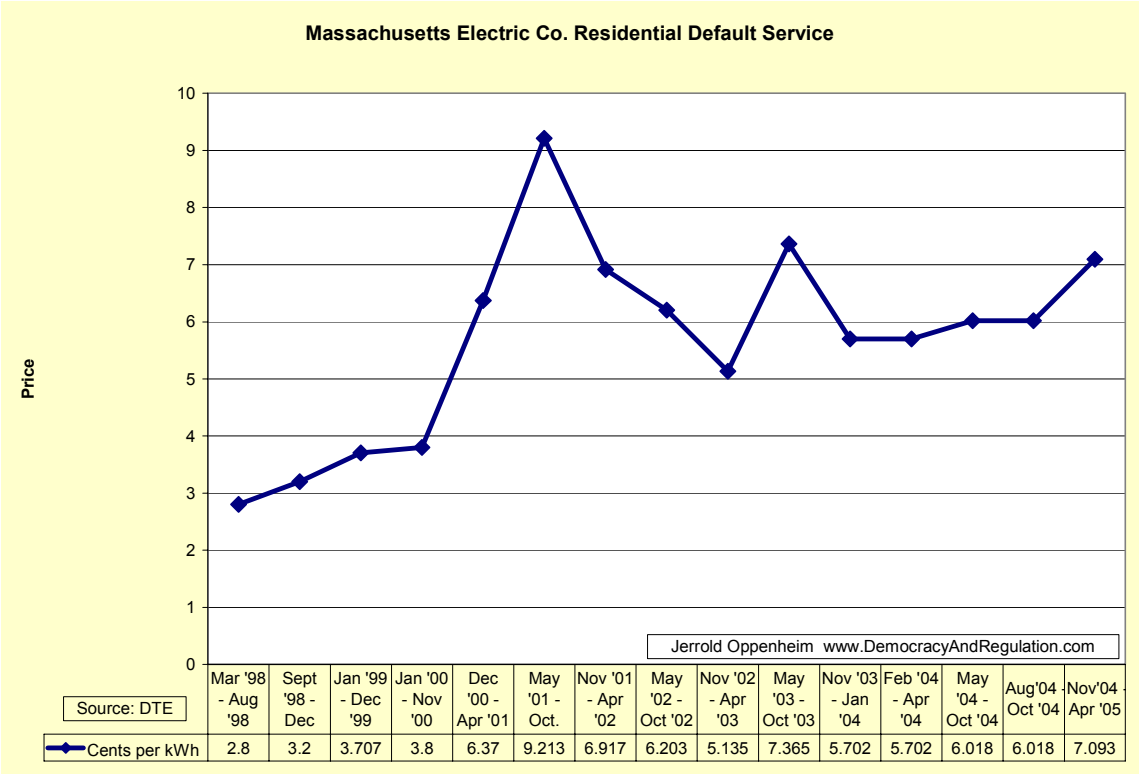
discount at the end of 2004 than at its beginning. At one utility, 12 percent of low-income customers were lost from the rolls.[9] MASSCAP estimates that only about one in five eligible electricity customers (22 percent) are actually receiving the low-income discount that the DTE and the General Court[10] have promised them.[11]

In most territories, the March 1 transfer from Standard Offer to Default Service will exacerbate this difference by increasing energy rates from December 2004 by as much as 28%.[12]

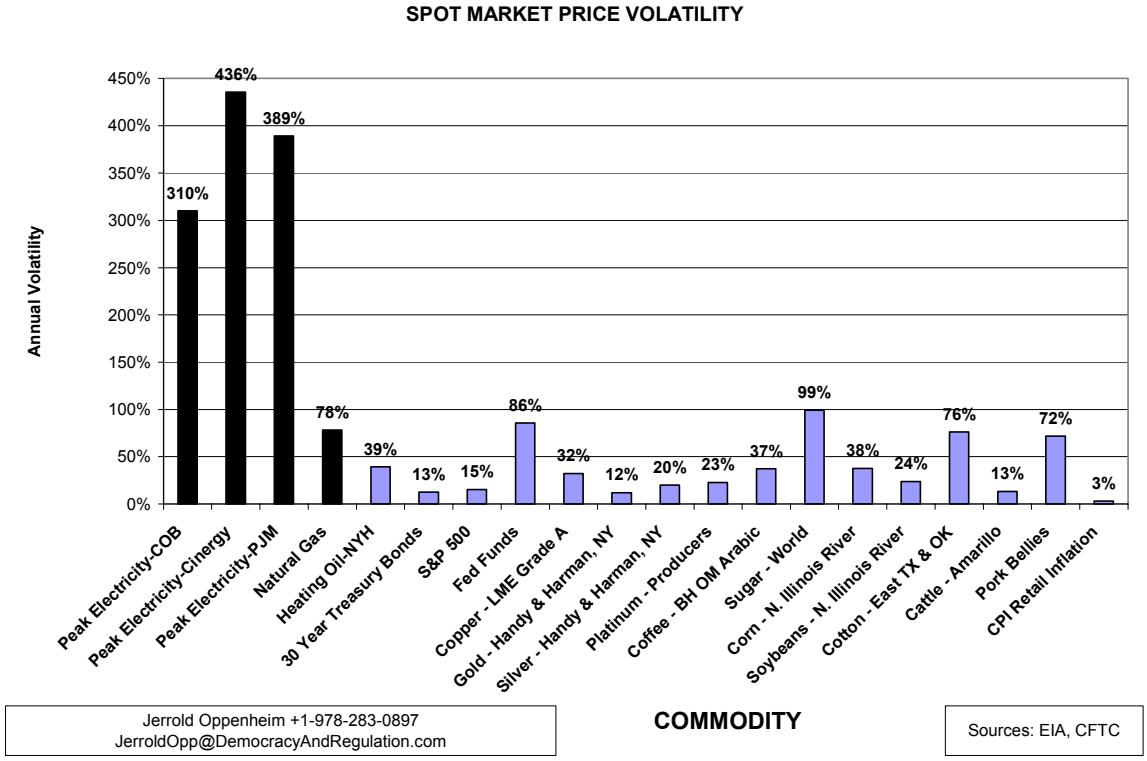
Inreases in Massachusetts Residential Electricty Energy Rates, March 2005	
Boston Edison Co.	18%
Cambridge Electric Light Co.	10%
Commonwealth Electric Co.	13%
Fitchburg Gas and Electric Co.	17%
Massachusetts Electric Co.	4%
Western Massachusetts Electric	28%
Source: DTE (March 2005 Default Service vs. December 2004 Standard Offer)	

The volatility of utility prices has been at least as difficult as price increases because it destroys efforts to budget already inadequate incomes. For example, the price of residential Default Service at Massachusetts Electric has varied by 79 percent over four years.

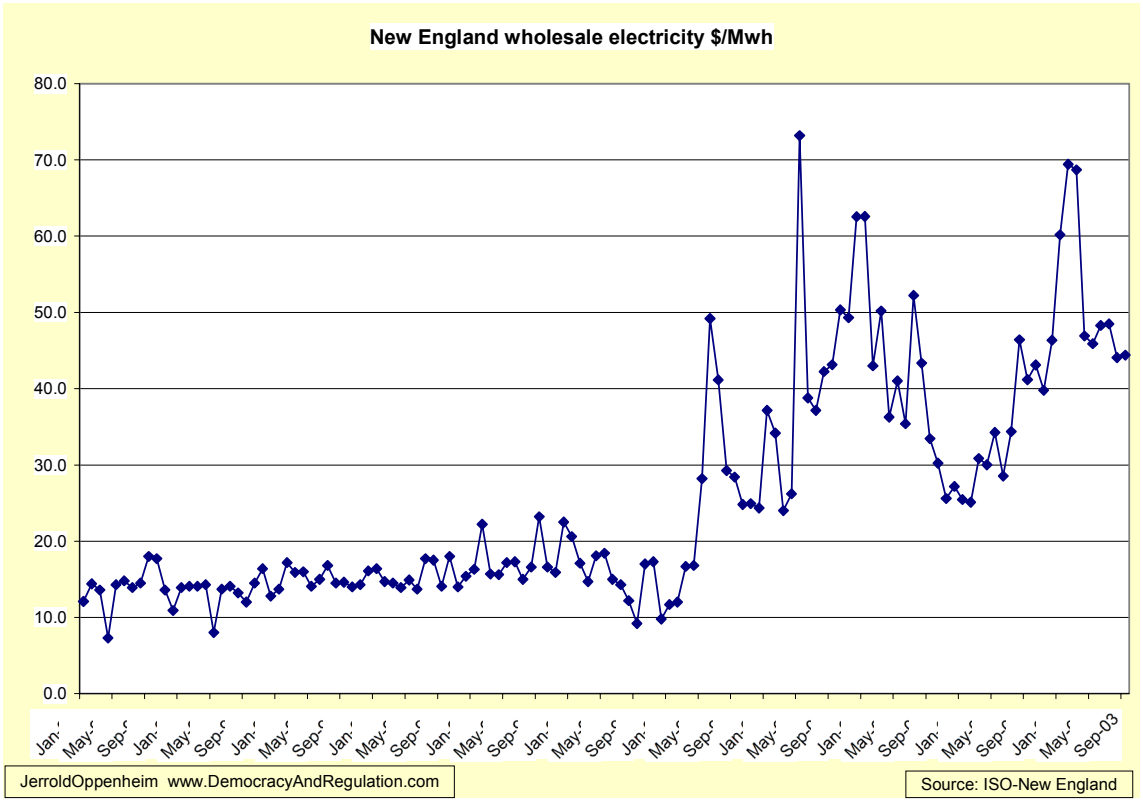
[9] Computed from data from Division of Energy Resources (DOER), Jan.-Nov. 2004 (Jan. 2005).
[10] G.L. c. 164, St. 1997, §193; c.164, §1F(4)(i).
[11] Discount recipients (147,950) from DOER. Eligible customers (675,167) from analysis of 2000 Census by utility by John Howat, National Consumer Law Center (NCLC). The NCLC analysis identifies households with incomes at or under 175% of the Federal Poverty Line, the eligibility standard for the discount, and municipal customers, and is based on average size of a fuel assistance household. An additional allowance of 3% was made to account for master-metered premises.
[12] Computed from data at http://www.mass.gov/dte/restruct/competition/standardoffer.htm; http://www.mass.gov/dte/restruct/competition/defaultservice.htm. (Roughly, bills will rise by about half of these percentages – still significant in most cases.) NSTAR increased Standard Offer rates in January; from that level the March increases are, of course, less: 12% (BECo), 4% (Cambridge), and 7% (ComElec).



Indeed, wholesale electricity prices are the most volatile of all commodities. Natural gas is next.



Upon their deregulation in March 1998, New England wholesale electricity prices followed this trend:



The Department's decision in 2002, moving from six month purchases[13] of all requirements to a more laddered approach of semi-annual purchases of 50 percent of requirements in one year contracts,[14] calmed retail price volatility to some extent. But, as the chart shows, prices have continued to vary substantially over short periods of time.

The economic context

This comes at a time when housing prices are skyrocketing. It takes a wage of $20.93 an hour, more than three times the $6.75 minimum wage, to afford the fair-market rent for a

[13] "Six-month contracts have proved to be only slightly less volatile and costly than spot market pricing." B. Biewald *et al.*, *Portfolio Management* at 47 (Synapse Energy Economics, Oct. 2003), www.synapse-energy.com/Downloads/Synapse-report-rap-ef-portfolio-management-10-10-2003.pdf.

[14] D.T.E. 02-40-B (2002). *See* Request for Comments at 3. Similarly, the Department has approved gas utility purchases – formerly a combination of about 40 percent storage and the balance spot purchases – to include purchases up to a year in advance. The Department has also sometimes employed deferrals to dampen the volatility of natural gas winter prices.

two bedroom apartment.[15] To put it another way, a Massachusetts minimum wage worker can afford the rent on a two bedroom apartment by working 115 hours a week.[16]

Incomes are not keeping pace with housing. Twenty percent of Boston renters pay more than half their incomes for shelter.[17] Between 1998 and 2002, Boston home prices increased four times faster than household incomes[18] -- 47 percent.[19] Prices are up 75 percent in the decade from 1994 to 2003. The price of heating oil in Massachusetts is 1.5 times (*i.e., well over double)* the price of January 1999.[20] The price of natural gas in Massachusetts is about double.[21] But low-income fuel assistance (LIHEAP) is about the same now as it was in 1981.[22] The grant that provided two tankfuls of heating oil now covers only one. In inflation-adjusted, purchasing power terms, the Massachusetts minimum wage has about the same value now as it had in 1980[23] and is considerably below the 175-200 percent of the Federal Poverty Line that is recognized in Massachusetts as the poverty line.[24]

As a fraction of income (energy burden), a family depending on a full-time minimum wage worker in Massachusetts spends three times as much on home energy (electricity and gas for heat) as a family with a median household income – as much as 13 percent of

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[15] Glen Johnson, "Mass. wages render affordable housing unaffordable," *Boston Globe* at A2 (Dec. 21, 2004), reporting National Low Income Housing Coalition study based on US Census and Bureau of Labor Statistics data. Affordability is defined as rent (at $1088 for a two bedroom apartment) and utility costs equal to or less than 30 percent of income.

[16] Sen. Edward M. Kennedy, "Democrats must emphasize their party's values," *The Gloucester Daily Times* at A10 (Jan. 15, 2005). An analysis by the National Low Income Housing Coalition (NLIHC) pegs the number at 124 hours at the minimum wage to afford the two bedroom Fair Market Rent (as determined by the US Department of Housing and Urban Development) of $1088. Winton Pitcoff *et al.*, *Out of Reach 2004* (NLIHC, 2004), state-specific data at http://www.nlihc.org/oor2004/data.php?getstate=on&state%5B%5D=MA.

[17] Penn Loh and Erica Schwarz, "An equitable vision needed for housing, transportation," *Boston Globe* at L11 (June 6, 2004).

[18] 89% vs. 22%. Patrick Barta, :After Long Boom, Weaknesses Appear in Housing Market," *Wall St. Journal* at 1 (Oct. 3, 2002), based on *Wall St. Journal* analysis of data from Economy.com.

[19] Joint Center for Housing Studies at Harvard University, *The State of the Nation's Housing*, Appendix Tables, TableW-2, from http://www.jchs.harvard.edu/.

[20] http://www.eia.doe.gov/emeu/states/oilprices/oilprices_ma.html (76.1 cents), http://www.mass.gov/doer/fuels/pricing.htm#oilsurvey ($1.90 at Jan. 11, 2005).

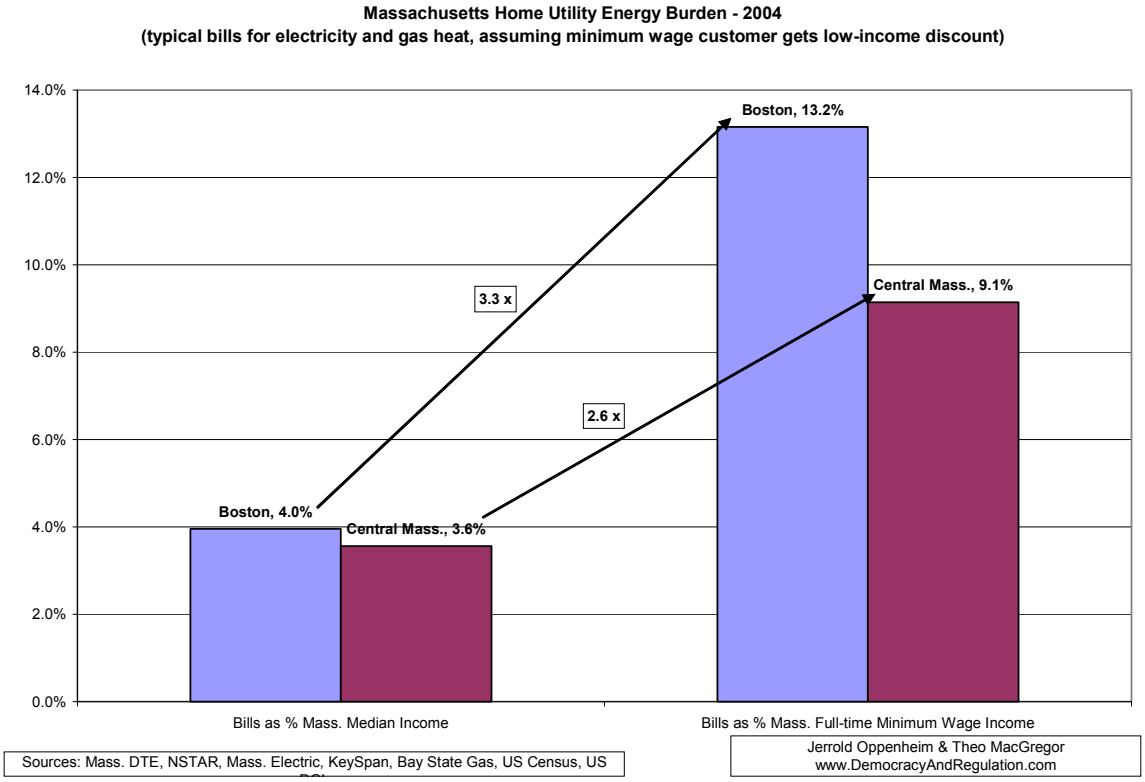
[21] http://www.eia.doe.gov/emeu/states/ngprices/ngprices_ma.html (for the last three months reported by EIA, August-October 2004, increases over 1999 are 82%, 106%, and 105%).

[22] Analysis by Charlie Harak, National Consumer Law Center. LIHEAP funding includes emergency allocations. Heating price change based on US Bureau of Labor Statistics Consumer Price Index for natural gas and home heating oil. A $15 million state supplement is pending in the General Court; while this is more than welcome, it will not fully restore the purchasing power of the lost LIHEAP funds. Even in nominal terms, it would bring LIHEAP funding up to (or nearly up to) the emergency years of 2003 and 2001.

[23] Jeff McLynch, *Keeping It Real: The Effects of Increasing and Indexing the Massachusetts Minimum Wage* at 6 (Massachusetts Budget and Policy Center, Nov. 2004), http://www.massbudget.org/Keeping%20It%20Real.pdf.

[24] *Ibid.* at 21. Massachusetts utility rate discounts are offered to customers with incomes below 175% of the Federal Poverty Line (FPL). Most Massachusetts low-income utility efficiency programs are offered to customers with incomes below 60% of the Commonwealth's median income, which usually equates to about 225% of the FPL.

income in Boston, on top of unaffordable rent. For the majority of low-income households not receiving the low-income rate, the burden is even higher – 16 percent. This gap is a consequence of the low-income wage falling to be a quarter of the median income while the low-income utility discount has shrunk to 15-17 percent instead of the design of up to 40 percent.[25]



As one might expect, the magnitude of price increases creates almost as much difficulty for utilities themselves as for their customers. A preliminary analysis of arrears data collected by the Department indicates that gas utility arrears entering this heating season roughly doubled from the end of the last heating season (last spring) and that arrearages this year are higher than they were last year. Low-income customers were having a particularly difficult time paying their gas and electricity bill increases. At one gas utility, for example, residential arrears rose 12 percent in December 2004 compared to December 2003 – but low-income arrears in the same period jumped 50 percent.[26]

[25] This assumes low-income customers receive the low-income discount, which most do not. Based on computations from typical R-1 and R-2 2004 utility bills by Theo MacGregor for MASSCAP, based on data from the DTE and Company web sites. Median income from US Census, based on 2000-2002 average.
[26] Analysis by counsel of 90-day arrears data per customer filed with the Department's Consumer Division. The data are incomplete at this writing so a full analysis is not possible at this time.

Indeed, for low-income families and households, utility bill increases are life-threatening.[27] Nutrition and medicine are sacrificed to pay utility bills -- or a family's health is put at risk with extreme temperatures by sharply turning down t heat or air conditioning.

A study by the National Bureau of Economic Research published in June 2002 concluded the following: "Expenditures on food in the home decreased in cold months for poor families but not for richer families…. This decrease in food expenditures by the poor are [*sic*] not offset by increased expenditures on food outside the home or on clothing."[28] And: "Among poor families,…a monthly temperature that was 10°F colder than normal would result in a reduction in expenditures on food in the home by $11/month and an increase in fuel expenditures by $37/month. Adults and children alike reduce their caloric intake by 10 percent during the winter months, whereas rich family members do not reduce their caloric intake during the winter."[29] Further: "Poor children outside the South consume 292 fewer calories in the winter relative to the summer, poor adults without children consume 299 fewer calories, while poor adults with children consume 374 fewer calories."[30] "Our results suggest that poor American families with children face stark choices in cold weather. In particular, they increase home fuel expenditures at the cost of expenditures on food and nutritional well-being."[31]

As for medicine, a study conducted by Mercier Associates on LIHEAP recipients in Iowa and published in June 2000 showed that "More than one of every five respondents to the "Iowa LIHEAP Energy Survey" (20.9%) reported going without medical care to pay for heating bills. Going without medical care may include not seeking medical assistance when it is needed, not filling prescriptions for medicine when the doctor has prescribed them, and/or not taking prescription medicines in the dosage ordered by the doctor…. Nearly one-in-five low-income Iowa seniors in the "Iowa LIHEAP Energy Survey" (19.1%) went without medical care to pay their heating bills. Unmet need for health care increases sharply as income declines among elderly. In 1994-95, 22 percent of persons 65 years and over that were poor reported unmet need for health care, ten times the rate for older persons with high incomes…. More than one-quarter (27.2%) of the wage earner households indicated they went without medical care at times in order to pay their heating bill. The wage earner, as with other households in the study, were making tradeoffs.[32]

Yet another study, found that "At least one in eight families with incomes between 100-200 percent of FPL still cannot obtain health insurance for their children, have not taken their child to a dentist in the last 12 months, and have moved three or more times in the

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[27] S. McGillicuddy, "Marshfield woman found dead in home; Police say heat was turned off and evidence indicates she froze to death," *The Patriot Ledger* (Quincy, Jan. 16, 2004).
[28] J. Bhattacharya *et al.,* "Heat Or Eat? Cold Weather Shocks And Nutrition In Poor American Families" at 11 (National Bureau Of Economic Research, Working Paper 9004, Cambridge, MA 02138, June 2002), http://www.nber.org/papers/w9004.
[29] At 19.
[30] At 17-18.
[31] At 20.
[32] J. Mercier, *et al.,* "Iowa's Cold Winters: LIHEAP Recipient Perspective" at 14-16 (Iowa Department of Human Rights, Division of Community Action Agencies, Bureau of Energy Assistance; June 2000).

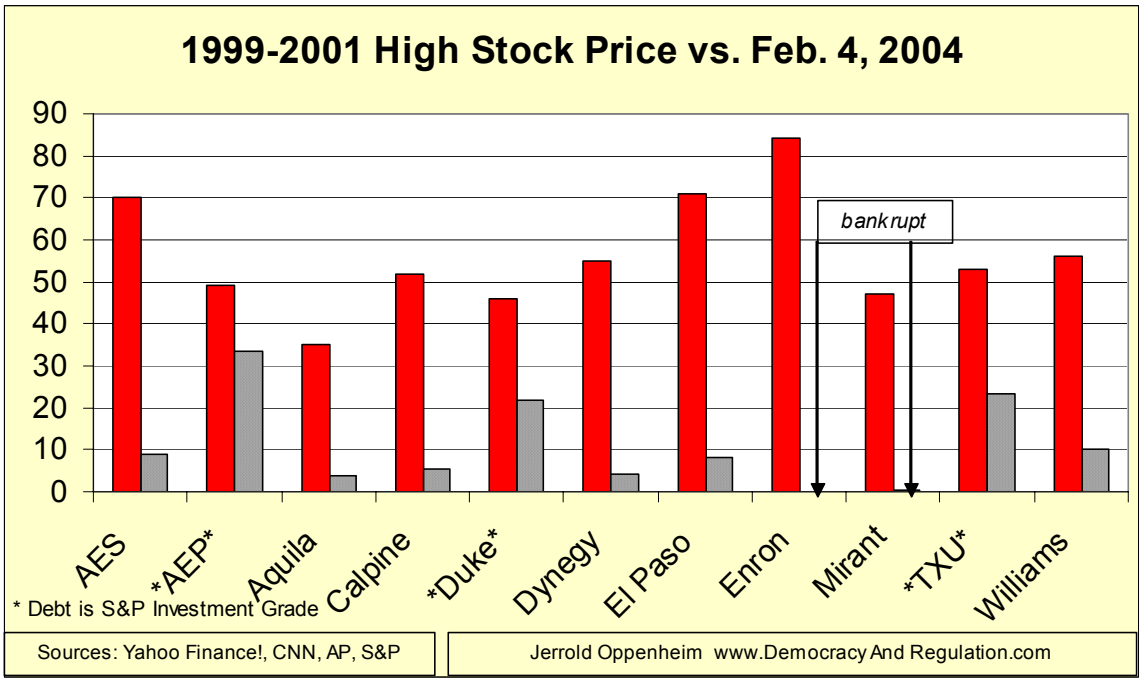
child's life… These findings are consistent with other research that 30 percent of families with incomes below twice the poverty line experienced at least one critical hardship, such as missing meals or eviction from their homes."[33] Almost ten percent of Massachusetts residents go without health insurance at least some of the year.[34]

Other studies show that families – and especially the elderly – sometimes reduce cooling when they cannot afford their electricity bills. A study by the Centers for Disease Control on heat-related deaths in Philadelphia states: "Mortality from all causes increases during heat waves, and excessive heat is an important contributing factor, particularly among the elderly (fn. omitted) …. The use of air conditioning reduces the risk for heatstroke and heat-related illness, even if it is available for only part of the day (fn. omitted). Because air conditioning is a protective factor, poverty is a risk factor for heat-related illness."[35]

Already unable to afford a decent home, adequate food, and medicine when needed, people with low incomes must deny nutrition to themselves or their children in order to keep them warm, give up critical medicines in order to stave off hypothermia, or move – sometimes to the streets – to avoid an unpayable utility bill.

Perhaps ironically, the sector most damaged by the industry's restructuring and subsequent price volatility has been the wholesale merchant generator industry itself. At least a third[36] of New England's generation has encountered financial difficulty, including the bankruptcies of Mirant, NRG Energy, and US Gen and distress sales by AES and Exelon. As share prices demonstrate, it would not be too much to say that the industry collapsed:

[33] E. Gershoff, "Low Income and Hardship Among America's Kindergartners" at 4 (Columbia University National Center for Children in Poverty, Living at the Edge, Research Brief No. 3, September 2003).
[34] Sen. Edward M. Kennedy, "Democrats must emphasize their party's values," *The Gloucester Daily Times* at A10 (Jan. 15, 2005) (630,000 residents –the Massachusetts population is 6,433,422 according to the US Census, http://quickfacts.census.gov/qfd/states/25000.html). According to Sen. Kennedy, 460,000 Massachusetts residents have no health insurance at all – 20,000 more than two years ago.
[35] US Centers for Disease Control and Prevention, "Heat-Related Deaths -- Philadelphia and United States, 1993-1994" (Morbidity and Mortality Weekly Report, July 01, 1994, 43(25); at 453-455).
[36] Computed by counsel from NEPOOL 2004 CELT, Sec. II.1 (plant by owner), Sec. 1 (Summer capability).



While devastating to the industry, this financial debacle has important repercussions for consumers. The financial instability of the industry makes it very difficult to finance new plant and, indeed, no new plant has been built in New England since the exuberance that immediately followed the enactment of restructuring. This has obvious implications for reliability, as well as for prices as generation becomes constrained. Further, one might expect investors to be somewhat more cautious about bankrolling sufficient plant to provide a reliability reserve, reasoning that the higher prices that come with market shortages are more likely to result in their recouping their loans.

The current path

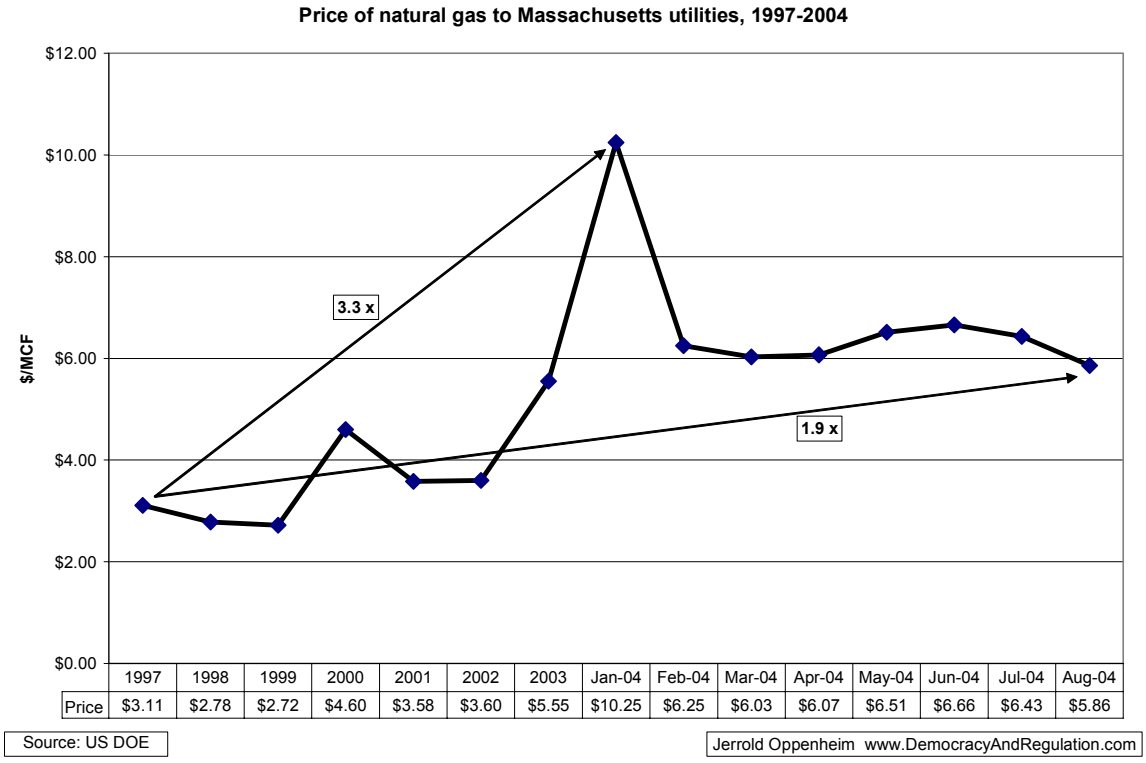
The current path of the Massachusetts utility industry is not difficult to plot. It leads to continued high and volatile prices putting increased pressure on low-income and other residential consumers, and decreasing reliability for at least four reasons.

1. Financial instability of the wholesale industry.

As explained above, the financial collapse of the wholesale electricity industry has cut off new generation construction, which will eventually mean constrained capacity, consequent higher prices, reduced reliability, and increased risk of brownouts and blackouts. The higher prices of electricity may bring financial health of a sort to the industry, but at an unacceptable cost in the loss of reliability.

2. Virtually every new generation plant in New England is fired by natural gas.

A resource that accounted for about two percent of New England's supply 20 years ago is now approaching half.[37] Predictably, this increase in demand against a constrained supply has contributed to an extraordinary increase in the price of gas – at least double, with a spike to more than triple:



The January 2004 spike represents a time when gas became so valuable that "generators with firm gas transportation engaged in fuel arbitrage, selling their firm gas supplies." Others had not secured firm supplies and could not operate.[38] Thus the "Dash to Gas" led to disruptive gas prices, shortages of gas for generation which brought New England's generation system to the brink of blackouts,[39] and ultimately causing a need for new supplies of expensive (and dangerous)[40] liquified natural gas (LNG).[41]

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[37] R. Smith, "Utilities Question Natural Gas Forecasting," *Wall St. Journal* at A2 (Dec. 27, 2004).
[38] ISO New England Market Monitoring Dept., at *Final Report on Electricity Supply Conditions in New England During the January 14-16, 2004 'Cold Snap,'* at 2 (Oct. 12, 2004)
[39] There are "capacity limitations to the natural gas pipeline network" to New England and many New England gas-fired generators do not have firm supplies of fuel. *Id.* at 1. The unplanned demand for natural gas "did push the electrical system in New England close to its limits. … [There was] a deficiency of the contingency reserve margin the ISO normally maintains to assure the reliability of the system." At 2. "Any shortfall in the availability of natural gas for power producers can cause a shortfall in power supply." At 3.
[40] M. Hightower, *et al., Guidance on Risk Analysis and Safety Implications of a Large Liquified Natural (LNG) Spill Over Water* (Sandia National Lab., Dec, 2004), http://fossil.energy.gov/news/techlines/2004/tl_sandia_lng.html.

3. Continued experiments to achieve reliability will cost consumers increasingly large price increases.

The pre-1997 wholesale marketplace operated by NEPOOL set wholesale energy prices at running costs, essentially the cost of fuel. System savings from running as a pool were shared.[42] When the New England wholesale electricity auction process was established, the rule was changed so that every winning bidder in each hour received the highest price bid. The theory was the excess of price over running costs would provide a sufficient contribution to capital costs to act as an adequate incentive to continue building generating plant to meet customer needs, including reserve needs. It did not work out that way. After an initial round of construction exuberance was followed by the decline in market prices that usually follows a supply glut, and the consequent financial distress described earlier, very little supply has been built in New England. This will ultimately lead to shortages, high prices, and, perhaps new construction to begin the boom-bust cycle anew.

"Locational Marginal Pricing" (LMP) was then invented to reflect transmission congestion costs, raise prices in transmission-constrained areas, and thus encourage investment inside those areas.[43] Instead, "LMP has significantly eroded the market value of existing generating assets [in New England] and effectively closed the door on new plants."[44]

Now comes an ISO Federal proposal, adopted by the Energy Regulatory Commission (FERC), for "locational installed capacity" (LICAP) charges to assure construction of adequate generation[45] at the price of a 25 percent energy price increase.[46] Experience has already taught that paying additional sums for generation does not by itself assure the construction of adequate generation.

4. World energy markets will most likely continue to bid up the prices of oil and coal, which will put some upward pressure on the price of natural gas.[47]

Chinese demand for coal and oil and instability in lands that are sources for US oil and LNG supplies are unlikely to let up in the foreseeable future.[48]

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[41] K. Costello, "Liquified natural gas: A prodigal returns to the market," *The Networker* at 1 (NRRI, Spring 2003).
[42] So, for example, when one utility purchased from a utility in the pool rather than running its own more expensive unit, the savings to the system were split between the two utilities.
[43] J. N. Philips, "LMP slashing plants' market value," *Power* at 50 (April 2004).
[44] *Ibid.*
[45] The Department held a Technical Conference on December 13, 2004 on this mechanism.
[46] *E.g.*, Direct Testimony of James G. Daly, Exh. No. AG Mass., *et al.*-1 in *Devon Power LLC, et al.,* Docket No. ER03-563-030 (Nov. 4, 2004); "FERC splits Conn. into two price zones," *Platt's* (Nov. 19, 2004), http://www.platts.com/Magazines/Platts%20T&D/News%20Archive/111904_5.xml.

[47] "Statistically the impact of storage on natural gas prices has become overwhelmed by the effect of crude oil." AG Edwards senior analyst Bill O'Grady *in* W. Burson, "Crude, Natural Gas Link Examined," GasTrader.net (Jan. 10, 2005) *in* PowerMarketers.com, *The Power Report* (Jan. 10, 2005).

Massachusetts policy since 1997

Massachusetts residential energy policy initiatives since 1997 have addressed choice, low-income concerns, price volatility, reliability, and, to some extent, price levels. Policy has had no impact on choice. Effective policies have been adopted to address low-income concerns, price volatility, and reliability, but serious problems remain. Price levels have not been effectively addressed.

1. Choice.

The Department has undertaken initiatives to encourage suppliers and marketers, such as providing private customer data to suppliers. As noted, these have had essentially no impact on choice in the residential market.

2. Low-income protections.

Policy in the Commonwealth has been solicitous of the difficulties of low-income utility consumers, for which MASSCAP is extremely grateful.

In 1997, the General Court enacted permanent low-income gas and electricity efficiency programs that are coordinated with each other and the US Department of Energy (DOE) Low-Income Weatherization Assistance Program (WAP) that is administered by the Department of Housing and Community Development (DHCD).[49] Massachusetts low-income efficiency programs lead the nation and have earned wide recognition for their comprehensiveness and effectiveness.[50] They assist low-income consumers to reduce their overall home energy consumption by about 18%,[51] which makes an important contribution to the ability of low-income families to afford their heating and electricity bills.

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[48] *E.g.,* G. Ip, "Greenspan Sees Long Term Effect In Oil, Gas Costs," *Wall St. Journal* at A2 (April 28, 2004); Associated Press, "Oil prices surge near $2 on supply fears: Attacks, US data fuel market rally," *Boston Globe* at E2 (Dec. 30, 2004); US DOE EIA, Annual Energy Outlook 2005 (Early Release), http://www.eia.doe.gov/oiaf/aeo/key.html; US DOE EIA, Annual Energy Outlook 2004, http://www.eia.doe.gov/oiaf/archive/aeo04/overview.html,; US DOE EIA, Country Analysis Briefs: China (July 2004), http://www.eia.doe.gov/emeu/cabs/china.html.

[49] G.L. c. 25, sec. 19, St. 1997, c. 164, sec. 37; G.L. c.25A, §11G, St. 1997, c. 164, §50.

[50] *E.g.,* American Council for an Energy-Efficiency Economy (ACEEE), "Fast Help for Soaring Gas Prices: Profiles of America's Best Natural Gas Energy Efficiency Programs" (Dec. 9, 2003), www.aceee.org/press/u035pr.htm; Martin Kushler, *et al.*, *Responding to the Natural Gas Crisis: America's Best Natural Gas Energy Efficiency Programs* (ACEEE, Dec. 2003), http://aceee.org/pubs/u035.htm, recognizing (among other Massachusetts programs), the coordinated delivery of low-income efficiency programs by the low income weatherization and fuel assistance program network pursuant to statute.

[51] Impact evaluation studies show savings of ten percent of electricity consumption and 20 percent (or more) of natural gas consumption. On a BTU basis, weighted for consumption, this works out to energy savings of about 18 percent.

Energy efficiency programs – including the non-low-income programs overseen by the Department, as well as Massachusetts programs to encourage renewable sources of energy[52] – also contribute to holding down the price and price volatility of natural gas and thus also of electricity.[53]

The General Court also codified existing low-income discount electricity rates and expanded eligibility for them.[54] However, the requirement "that distribution companies provide discounted rates for low income customers comparable to the low-income discount rate in effect prior to March 1, 1998" has so far been interpreted to exclude application of the discount to the substantial energy price increases that have occurred since 1997. As a result, as described above, the value of the low-income discounts for electricity and gas have eroded by as much as 25 percent and 87 percent, respectively.

The General Court also instructed that "Each distribution company shall conduct substantial outreach efforts to make said low-income discount available to eligible customers." Massachusetts gas and electric utilities have been very cooperative in joining with the low income weatherization and fuel assistance program network to promote low-income energy benefits in a multi-media campaign known as Energy Bucks. Evaluation of this campaign has not been completed and there are many cross-cutting factors. However, one trend that is apparent, as described above, is that the number of low-income discount recipients declined by six percent in 2004.

In order to enhance outreach efforts, the General Court specifically authorized "establishing an automated program of matching customer accounts with lists of recipients of said means-tested public benefits programs and based on the results of said matching program, to presumptively offer a low-income discount rate to eligible customers so identified." The Department recently put such a matching program into effect and secured the cooperation of important state agencies to help carry it out.[55]

Finally, three Massachusetts utilities have pioneered arrearage management programs in an effort to assist low-income clients manage their budgets. NSTAR Electric,[56] KeySpan,[57] and Western Massachusetts Electric Co.[58] – each in a different way – provide

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[52] G.L. c. 25, sec. 20, St. 1997, c. 164, sec. 37 (Mass. Renewable Energy Trust); G.L. c. 25A, sec. 11F, St. 1997, c. 164, sec. 50 (renewable energy portfolio standard).

[53] R. Neal Elliott *et al., Impacts of Energy Efficiency and Renewable Energy on Natural Gas Markets* (ACEEE, Dep. 2003), http://aceee.org/energy/efnatgas-study.htm. *See also* Union of ep.2 003),Scientsts, "Renewing America's Economy" (n.d.), http://www.ucsusa.org/clean_energy/renewable_energy/page.cfm?pageID=1505.

[54] G.L. c. 164, §1F(4)(i), St. 1997, c. 164, §193.

[55] D.T.E. 01-016-B (Dec. 6, 2004).

[56] Amended Settlement Agreement, D.P.U. 90-3C/D.P.U. 91-80 (Nov. 2002). This program operates in the former Commonwealth Electric Service territory. NSTAR also operates a smaller pilot arrears management program in coordination with a grant from the US Department of Health and Human Services (HHS), administered by DHCD, and implemented by the weatherization and fuel assistance program network.

[57] *Boston Gas Co. d/b/a KeySpan Energy Delivery New England* at 508-509, D.T.E. 03-40 (Oct. 31, 2003). KeySpan also operates a smaller pilot arrears management program in coordination with a grant from HHS, administered by DHCD, and implemented by the weatherization and fuel assistance program network.

[58] Settlement Agreement and amendment, Article VIII, in D.T.E. 04-106 (November 2004).

a combination of counseling and arrearage forgiveness conditioned on customers' meeting specified payment agreements. As the Department explained in its discussion of KeySpan's "On-Track" arrearage program:

> The On-Track program can educate and counsel low-income ratepayers with poor bill payment history in methods to better manage their finances. The On-Track program may likely enable the Company to lower its bad debt expense which, in the future, could benefit all ratepayers. Evidence indicates that a similar program has enjoyed some success in New York. … The Department supports the implementation of the On-Track program and, if managing payment and bad debt programs in this way is beneficial to all ratepayers, encourages all gas and electric distribution companies to explore implementation of low-income assistance programs similar to On-Track.[59]

"With the prices of oil, gas and other fuels on the rise, the expansion of this [NUStart arrears] program is an important initiative. Expansion of low income programs are supported by the Department."[60] MASSCAP very much appreciates the Department's support of these programs and will provide evaluative data about their results as they become available.

3. Price volatility.

As noted above, the Department has followed a policy of dampening price volatility by extending the length of gas and electricity purchase contract terms and "laddering" electricity contracts so they do not expire at once.

To the extent that they lower overall demand, particularly at peaks, the General Court's and Department's policies encouraging energy efficiency and renewable energy also have the effect of reducing price volatility.

Despite these salutary policies, external forces have continued with such power as to produce increasing and volatile gas and electricity prices and overwhelm the Commonwealth's efforts to date to protect its residents.

4. Bulk reliability.

The immediate response of the wholesale electricity industry to the 1997 electricity industry restructuring statute was to build far more generation plant than would be needed for quite some time. Reserve capacity in 1998 was a dangerous five percent.[61] Now, according to the last CELT, NEPOOL's latest reported reserve capacity (for 2003, five years later) was a comfortable 25 percent.[62] On the other hand, the NEPOOL

[59] *Boston Gas Co. d/b/a KeySpan Energy Delivery New England* at 511, D.T.E. 03-40 (Oct. 31, 2003).
[60] *Western Massachusetts Electric Co.* at 11, D.T.E. 04-106 (Dec. 29, 2004).
[61] NEPOOL 1999 CELT Report, sec. 1,p. 1, www.iso-ne.com (Periodic Reports).
[62] NEPOOL, 2004 CELT Report, sec. I.1. www.iso-ne.com (Periodic Reports).

projection in 2000 for 2003 – just three years ahead -- was for a 38 percent reserve.[63] Comfortable reserves can disappear quickly.

Very little New England generation has been added since 2000, for the reasons described earlier. NEPOOL projects the summer planning reserve capacity falling below 15 percent in eight years, by 2013[64] and history teaches that this estimated shortage could occur much sooner. It is possible that actions in the marketplace, or by the FERC, will result in generation construction in time to avoid such a reliability problem. Certainly, the Commonwealth's policies to support energy efficiency and renewable energy lead in this direction. The short history of deregulation is, however, not reassuring. As described above, the deregulated wholesale marketplace has managed itself into a financial shambles and little New England generation has been built since the initial overconstruction. Unanticipated economic activity or plant shutdowns can quickly turn the next few years of comfortable reserve margins into tight summers of brownouts or worse.

Generation shortages would have severe adverse economic, health, and social consequences. The Commonwealth should have a policy in place so we are prepared in case the market and federal forces we are counting on for reliability in fact fail to provide Massachusetts with a reliable electricity supply.

The situation with respect to natural gas reliability is even more precarious. Not only did too many build power plants at once in reaction to the looming shortage of power at the end of the 1990s, but everyone built more or less the same type of plant, without regard to whether the natural gas all the new plants planned to use was actually available in the quantities required. As described above, we found out last winter that, when it gets very cold, it is not. Yet the invisible hand of the marketplace was apparently so certain of supply that many plant operators did not line up firm gas supply at all.

5. Price levels.

The Commonwealth's principle policy with respect to energy prices is to rely on the marketplace. In 1997, it was thought that a competitive marketplace would operate more efficiently and less expensively that the regulated system it replaced. As we all know, it did not work out this way.

In principle, market prices respond to changes in supply and demand, so increases in supply and decreases in demand (all else being equal) should result in lower prices. Indeed, as noted, the Commonwealth's energy efficiency and renewable energy policies (including appliance efficiency standards) reduce demand and, to this extent, reduce pressure on gas and electricity prices.

On the supply side, the Commonwealth's policy has been to drive down prices by using marketplace forces, as set forth in this legislative finding:

[63] NEPOOL 2000 CELT Report, sec. 1,p. 1, www.iso-ne.com (Periodic Reports).
[64] NEPOOL, 2004 CELT Report, sec. I.1. www.iso-ne.com (Periodic Reports).

> long-term rate reductions can be achieved most effectively by increasing competition and enabling broad consumer choice in generation service, thereby allowing market forces to play the principal role in determining the suppliers of generation for all customers.[65]

Left open is the question of how market forces are to be marshaled in order to achieve long-term rate reductions. On the evidence to date, with energy rates 2.5+ times the rates of March 1998,[66] the methods tried do not work.

MASSCAP's policy recommendations

1. Choice

The lack of residential retail competition indicates that marketers have not found the residential electricity sector to be an appealing business. Research suggests most potential residential customers reciprocate this lack of interest. Indeed, in one research experiment, people who reacted enthusiastically to a shop window displaying a large markdown on a Sony appliance purchased much less when a second appliance with a similar markdown was added.[67] "[A] point is reached at which increased choice brings increased misery rather than increased opportunity. It appears that American society has long since passed that point."[68] The American consumer response is " 'outsourcing' choice. They hire critics … That, in effect, is what a 'brand' is."[69] It seems empirically clear that Massachusetts electricity consumers are content to rely on experts – public utilities, supervised by this Department – to make their choices of electricity (and gas) supplier.

2. Low-income protections: "the restructuring of the existing electricity system should not undermine the policy of the commonwealth that electricity bills for low income residents should remain as affordable as possible."[70]

As described above, the value of the electricity and gas low-income discount rate has shrunk by as much as 25 percent and 87 percent, respectively. As a result, low-income electricity customers have suffered rate increases of 32 to 47 percent -- 41 percent greater than those for other residential customers.

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[65] St. 1997, c. 164, sec. 1(k).
[66] March 2005 Default Service rates for each utility divided by the uniform March 1998 rate of 2.8 cents. The range is 2.5 to 2.7 times. http://www.mass.gov/dte/restruct/competition/defaultservice.htm#Fixed%20Default%20Service%20Prices.
[67] C. Caldwell, "Select All," *The New Yorker* at 91 (March 1, 2004). The example is from B. Schwartz, *The Paradox of Choice* (New York: Ecco/HarperCollins, 2004).
[68] B. Schwartz, "The Tyranny of Choice," *Scientific American* at 71, 75 (April 2004). Another accessible summary of Schwartz' work is B. Schwartz, "Nation of Second Guesses," *The New York Times* (op-ed, Jan. 22, 2004).
[69] C. Caldwell, "Select All," *The New Yorker* at 91, 93 (March 1, 2004), citing R. Reich, *The Future of Success*.
[70] St. 1997, c.164, sec. 1(n).

The resolution of this inequity is straightforward: amend Default Service regulations to restore the value of the low-income discount to its full value at the time of the passage of the 1997 restructuring act. The discount should continue to be applied to the distribution portion of bills but should reflect the amount necessary to achieve a constant percentage reduction from the entire bill, including the volatile energy portion.[71]

Of course, the resulting bill increases will still be far greater than many can handle. Families at the economic edge can be knocked over that edge by uninsured illness, loss of a few weeks of work, or spikes in utility bills. While budget billing plans are helpful, low-income families are nevertheless often saddled with arrearages that they cannot pay. As described above, NSTAR, KeySpan, and Western Massachusetts Electric Co. have adopted arrearage management plans to counsel low-income families in such situations and to exchange arrearage forgiveness for regular payments; the Department has been very supportive in the development of these programs.[72] MASSCAP asks that the Department undertake to review the results of these programs as they become available in order to consider their expansion across the Commonwealth.

3. Price volatility: Default Service purchasing should be reformed with longer purchase terms in order to enhance the stability of residential prices

The Department's shift to laddered one-year contracts for 50 percent of the load has protected residential customers from a substantial part of the wholesale electricity price volatility. Lengthening some contracts would stabilize retail prices further and would increase customer protection at times of high wholesale price volatility.[73] "Laddering" – staggering purchases so replacement of expiring contracts does not happen all at once – also dampens retail price volatility.[74]

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[71] The same policy should be adopted for natural gas rates. Residential gas heating bills have jumped 42%-75% since 1999, but low-income bills have skyrocketed 51%-96% -- an increase that is greater by 21%-28%. Survey for MASSCAP by Theo MacGregor of Bay State Gas, KeySpan, and NSTAR rates from DTE and Company web sites (Dec. 6, 2004).

[72] It is useful to distinguish between low-income customers who want to pay their bills but are financially unable to do so and customers with adequate means who choose to not pay their bills. Account must also be taken of those households with more permanently inadequate financial circumstances. This is an oversimplification of the seminal paper by R.Grosse, "Win-win Alternatives for Credit & Collections" (Wisconsin Public Services Corp., 1995, rev. 1997). Grosse, then Manager of Customer Accounts, reported these results at WPSC: substantial reductions in terminations (on the order of 80% fewer) combined with increase use of payment plans and a program of home visits by Customer Assistance Advisors brought no increase in direct costs (direct labor, write-offs), no increase in net write-offs or residential arrears, less turnover in the credit department, and a decrease in customer fraud. At 10-13. KeySpan operates its smaller but otherwise similar On-Track program at Boston Gas on a shareholder-funded basis, since it expects lower termination and customer contact costs and increased payments due to more regular payment (experience in Brooklyn was $190 per customer per year). *Boston Gas Co. d/b/a KeySpan Energy Delivery New England* at 510-511, D.T.E. 03-40 (Oct. 31, 2003).

[73] Data in *Initial Comments of NSTAR Electric* in this docket at 10-13 (Jan. 10, 2005). *Accord, Comments of the Attorney General* at 5-6, 8-11 (Jan. 10, 2005); *Comments of Utility Workers of America, Local 369* at 4-6 (Jan. 10, 2005).

[74] *Initial Comments of NSTAR Electric* in this docket at 19 n.6 (Jan. 10, 2005).

Accordingly, MASSCAP endorses proposals to increase the term of Default Service procurements.[75] MASSCAP concurs that, initially, procurement might be divided equally in one-, two-, and three-year contracts, with a small fraction of spot purchasing for load balancing.[76] As the market develops, however, longer term contracts should be considered if available.[77] In developing the mix of contract segments and durations, the trade-offs that should be considered include:[78]

- Wholesale prices vary, sometimes substantially, over time.
- Short-term (spot) contracts provide flexibility to meet uncertain demand, but can be extremely volatile in price.
- At the other extreme, long-term contracts are inflexible but reduce market risks for suppliers and therefore price level and price volatility.
- "Across many industries and over long periods of time, the optimal approach to portfolio management is generally found to be a balance of contracts of varying durations, price terms, and raw materials [*e.g.,* fuels], and some small reliance on spot market, possibly supplemented with hedging instruments. In addition, long-term contracts or plant ownership can be 'economically efficient' and make good sense in some situations."[79]

As noted earlier, electric industry restructuring has been characterized by, among other things, the creation of new risks and thus new costs for consumers. For example, price volatility and the absence of planning has made the electricity generation business much riskier than it was as part of a regulated utility. These risks have been translated at retail to higher and more volatile prices as well as diminished reliability. Care should be taken to avoid repeating the mistake of reforming the system by adding additional risk, and thus cost, to it.

Utility skepticism about contract terms of more than one year may be based in large measure on the additional risk they perceived imposed on them in case, for example,

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[75] MASSCAP concurs, however, with the view that Cape [Cod] Light Compact's aggregation process should be protected. *Initial Comments of The Cape Light Compact* at 6 (Jan. 10, 2005).

[76] *Comments of the Attorney General* at 8-11 (Jan. 10, 2005); *Comments of Fitchburg Gas & Electric Light Co.,* at 2 (Jan. 10, 2005); *Initial Comments of Duke Energy North America,* LLC at 1 (January 10, 2005); Comments *of Constellation NewEnergy Inc. et al.* 4-5 (January 9, 2005) (six to 36 months). Maryland and New Jersey require a mix of one-, two-, and three-year contracts; the District of Columbia recommends such a approach. Connecticut requires a laddered mix of durations. A. Roschelle *et al.*, "Best Practices in Procurement of Default Electric Service: A Portfolio Management Approach," *Electricity Journal* at 63, 66 (Table 1) (Oct. 2004).

[77] *Accord, Initial Comments of Union of Concerned Scientists, et al.* at 7-11 (Jan. 10, 2005). Morgan Stanley recommends up to five years in order to lower prices. *Comments of Morgan Stanley Capital Group Inc.* at 5 (Jan. 10, 2005). Longer terms for natural gas are currently available.

[78] *See generally,* B. Biewald, *Portfolio Management* (Synapse Energy Economics, Oct. 2003), www.synapse-energy.com/Downloads/Synapse-report-rap-ef-portfolio-management-10-10-2003.pdf; A. Roschelle *et al.*, "Best Practices in Procurement of Default Electric Service: A Portfolio Management Approach," *Electricity Journal* at 63 (Oct. 2004).

[79] B. Biewald, *Portfolio Management* (Synapse Energy Economics, Oct. 2003) at A-13, www.synapse-energy.com/Downloads/Synapse-report-rap-ef-portfolio-management-10-10-2003.pdf.

prices move in an unpopular direction.[80] Care should be taken to provide a reasonable level of certainty, subject to oversight for prudence but perhaps balanced by a pre-approval mechanism similar to that now in place for energy efficiency programs.

Because economic conditions are likely to change over time, MASSCAP recommends adoption of a rule consistent with that adopted by the Connecticut Legislature, which has led the way in specifying a laddering approach:[81]

> (3) An electric distribution company providing electric generation services pursuant to this subsection shall mitigate the variation of the price of the service offered to its customers by procuring electric generation services contracts in the manner prescribed in a plan approved by the department. Such plan shall require the procurement of a portfolio of service contracts sufficient to meet the projected load of the electric distribution company. Such plan shall require that the portfolio of service contracts be procured in an overlapping pattern of fixed periods at such times and in such manner and duration as the department determines to be most likely to produce just, reasonable and reasonably stable retail rates while reflecting underlying wholesale market prices over time. The portfolio of contracts shall be assembled in such manner as to invite competition; guard against favoritism, improvidence, extravagance, fraud and corruption; and secure a reliable electricity supply while avoiding unusual, anomalous or excessive pricing. The portfolio of contracts procured under such plan shall be for terms of not less than six months, provided contracts for shorter periods may be procured under such conditions as the department shall prescribe to (A) ensure the lowest rates possible for end-use customers; (B) ensure reliable service under extraordinary circumstances; and (C) ensure the prudent management of the contract portfolio. An electric distribution company may receive a bid for an electric generation services contract from any of its

[80] *See Comments of Massachusetts Electric Co. and Nantucket Electric Co.* at 8-10 (Dec. 23, 2004).
[81] Connecticut General Statutes, Section 16-244c(3) and (4), Public Act No. 03-135 (2003): This provision is effective with the beginning of "standard service," currently schedule to commence January 1, 2007.

> generation entities or affiliates, provided such generation entity or affiliate submits its bid the business day preceding the first day on which an unaffiliated electric supplier may submit its bid and further provided the electric distribution company and the generation entity or affiliate are in compliance with the code of conduct established in section 16-244h.
> (4) The department, in consultation with the Office of Consumer Counsel, shall retain the services of a third-party entity with expertise in the area of energy procurement to oversee the initial development of the request for proposals and the procurement of contracts by an electric distribution company for the provision of electric generation services offered pursuant to this subsection. Costs associated with the retention of such third-party entity shall be included in the cost of electric generation services that is included in such price.

NSTAR and Western Massachusetts Electric Co.[82]express a strong desire to continue to conduct Default Service procurement themselves[83] and clearly have the capacity to do so. Massachusetts Electric Co. is open to statewide procurement, [84] as Fitchburg Gas & Electric Light Co. (perhaps because of its relatively small size) also appears to be.[85]

The diversity of opinion probably reflects with accuracy the lack of certainty about the best approach. MASSCAP proposes leaving the decision up to each utility. That is, each utility should have the option of conducting purchases itself, as now, or of turning the purchasing function over to the Department (which would be guided by consultants in the manner of Maine and New Jersey).[86] Fitchburg, with the smallest load, may find it practical to consolidate its purchasing with another utility in the Commonwealth.

MASSCAP concurs with those who find no evidence that any process is superior to the current RFP bidding process.[87]

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[82] *Initial Comments of Western Massachusetts Electric Co.* at 11-15 (Jan. 10, 2004).
[83] *Initial Comments of NSTAR Electric* at 21-26 (Jan. 10, 2005).
[84] *Comments of Massachusetts Electric Co. and Nantucket Electric Co.* at 11-13 (Dec. 23, 2004).
[85] *Comments of Fitchburg Gas & Electric Light Co.,* at 4-5 (Jan. 10, 2005).
[86] If it mattered to the utility, the Department's process could include two sets of prices in the bidding process, one where utilities take title to the electricity and one where they do not.
[87] *Initial Comments of NSTAR Electric* at 26-28 (Jan. 10, 2005); *Initial Comments of Western Massachusetts Electric Co.* at 15-16 (Jan. 10, 2004); *Comments of Fitchburg Gas & Electric Light Co.,* at 5 (Jan. 10, 2005).

Finally, it should be noted that the energy efficiency and renewable energy promoted by current policy also make significant contributions to the control of price volatility, as wel as of price levels.[88]

4. Reliability and price level: a regulated Builder of last Resort is needed to assure bulk reliability and to help control prices.

Few issues generate as much consensus as the need for reliability of the bulk power supply. For this reason, MASSSCAP recommends that a Builder of Last Resort be appointed to build generation on a cost-of-service basis if the market fails to provide the requisite reliability. This will also have the effect of disciplining what might otherwise be shortage prices.

This is exactly what occurred in New York City in 2000 when the New York Power Authority (NYPA), at the request of the New York Public Service Commission, built 11 small generators (450 mw) in and around New York City in order to head off what looked like an imminent power shortage in the summer of 2001. "The additional power generated by these new generators was considered crucial in meeting the area's peak demands during the summer months, and NYPA's responsiveness was commended by the Public Service Commission."[89] The advantage of cost-of-service plant to ratepayers is demonstrated by the impact of re-assigning all utility-owned Public Service of New Hampshire generation to residential customers, which would reduce the energy rate 4.4 percent, from 6.49 cents to 6.2[90] -- a far cry from proposals to increase rates 20 percent in order to entice merchant power plant construction.

A review of the 1997 Restructuring Act shows that appointment of a Builder of Last Resort is well within the Department's current authority:

> The department is hereby authorized and directed to promulgate rules and regulations necessary to carry out the provisions of this section, including the procedure for default service procurement.[91]
>
> Beginning on March 1, 1998, each distribution company shall provide its customers with default service and shall offer a default service rate to its customers who have

[88] Elliott *et al., Natural Gas Price Effects of Energy Efficiency and Renewable Energy Practices and Policies* (ACEEE, Dec. 2003), http://aceee.org/pubs/e032full.pdf, http://aceee.org/energy/efnatgas-study.htm.

[89] New York State Office of the Comptroller, *New York Power Authority: Power Generation in the New York City Area* at 3-5, 112, 119 (May 2004). This report is critical of NYPA for shortcuts taken in its decision-making process. This construction was conducted on an emergency basis. Plainly, it could have been performed more efficiently if there had been an advance plan to deal with potential power shortages. www.osc.state.ny.us/audits/allaudits/093004/01s64.pdf.

[90] "Approval of Proposed Rate Increase Due," *Energy, Utilities and Telecommunications Update* at 1 (McLane, Graf, Raulerson & Middleton,Jan. 2005).

[91] G.L. c. 164, sec. 1B(f), St. 1997, c. 164, sec. 193.

> chosen retail electricity service from a non-utility affiliated generation company or supplier but who require electric service because of a failure of such company or the supplier to provide contracted service or who, for any reason, have stopped receiving such service, and to all customers at the end of the term of the standard offer. The distribution company shall procure such service through competitive bidding; provided, however, that the default service rate so procured shall not exceed the average monthly market price of electricity; and provided, further, that all bids shall include payment options with rates that remain uniform for periods of up to six months. Any department-approved provider of service, including an affiliate of a distribution company, shall be eligible to participate in the competitive bidding process. Notwithstanding the actual issuer of a ratepayer's bill, the default service provider shall be entitled to furnish a one-page insert accompanying the ratepayer's bill. The department may authorize an alternate generation company or supplier to provide default service, as described herein, if such alternate service is in the public interest. In implementing the provisions of this section, the department shall ensure universal service for all ratepayers and sufficient funding to meet the need therefor.[92]

The General Court thus requires a competitive bidding process, in which a distribution company affiliate can bid, to supply Default Service. It is otherwise delegated to the Department to set the rules for procurement, which can presumably include allowing or ordering a utility to bid at its cost of service.

As with longer-term contracting, utility concerns about potential new risks in the system should be addressed. It should be kept in mind that appointment of a Builder of Last Resort reduces the reliability risks of the current boom-bust construction cycle.

[92] G.L. c. 164, sec.1B(d), St. 1997, c. 164, sec. 193.

Summary Answers to Questions

Based on the foregoing, MASSCAP submits the following answers to the Department's questions:

1. Would smaller customers be better served if power supply for default service is procured using a portfolio of more than two solicitations?
2. Would smaller customers be better served if power supply for default service was procured for a term longer than twelve months?

MASSCAP submits that power should be procured using a mix of laddered contracts up to at least three years in duration, longer as longer terms become reasonably available in the wholesale marketplace. This policy should govern the number of solicitations.

A mix of contracts that include longer terms will most likely produce lower prices over the long term and will certainly produce more stable prices. Migration can be accommodated by using spot purchases to balance load.

3. Would smaller customers be better served if power supply for default service was procured on a statewide basis?

No. However, MASSCAP has no objection if a particular utility prefers that the Department conduct the procurement process for its territory.

4. Would smaller customers be better served if power supply for default service was procured using an auction process (*e.g.,* descending clock) rather than through requests for proposals?

There is no convincing evidence that this is the case.

5. Is there some better or more descriptive term that ought to be used by the distribution companies in place of "default service"?

MASSCAP has no objection to the proposal to use the term "Basic Service."

Respectfully submitted,
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